

Report of the auditor-general to the Free State Legislature and the council on the Mafube Local Municipality

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Mafube Local Municipality set out on pages ... to ... and ... to, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), the Division of Revenue Act, 2015 (Act No. 1 of 2015) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Disclaimer of opinion

Payables from exchange transactions

4. I was unable to obtain sufficient appropriate audit evidence for trade payables, accrued expenses, salary control accounts, retention creditors and advance payables included in payables from exchange transactions due to the unavailability of reconciliations or support for these balances. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any adjustments to these balances stated at R130 809 575 (2015: R126 238 118) and included in the amount of R352 870 500 (2015: R274 867 634) as disclosed in note 21 to the financial statements, were necessary. In addition, differences were identified between the amounts disclosed in the previous year's financial statements and external confirmations as well as differences on debtors with credit balances. Consequently, payables from exchange transactions and expenditure were understated in the previous financial year by R31 133 561. There was also a resultant impact on the deficit for the period and the accumulated surplus.

Consumer receivables from exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence for consumer debtors due to several unexplained differences or supporting documents that could not be provided. Support could also not be provided for the calculation of the provision for impairment of debtors. I was unable to confirm consumer debtors by alternative means. Consequently, I was unable to determine whether any adjustments to consumer debtors stated at R120 617 069 (2015: R63 954 782) in note 12 to the financial statements were necessary.

Receivables from non-exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence for the provision for impairment of rates debtors as support could not be provided for the calculation. I was unable to confirm the provision for impairment of rates debtors by alternative means. Consequently, I was unable to determine whether any adjustment to the rates impairment stated at R15 106 739 (2015: 19 172 701) in note 11 to the financial statements was necessary.

Statement of changes in net assets

7. The municipality did not disclose the required detail in respect of the material prior period errors in the statement of changes in net assets as required by GRAP 1 *Presentation of financial statements*. Material misstatements found in the prior period errors note 47 that could not confirmed, as the detail was not disclosed in the statement of changes in net assets.

Property rates

8. During 2015, I was unable to obtain sufficient appropriate audit evidence for property rates and to confirm the property rates by alternative means. Consequently, I was unable to determine whether any adjustments to property rates stated at R21 152 561 was necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Financial instruments

9. The amount disclosed as financial instruments in note 24 to the financial statements does not include payables from exchange transactions of R352 870 500 as well as other financial assets, receivables from exchange transactions, receivables from non- exchange transactions, consumer receivables from exchange transactions and cash and cash equivalents of R144 038 951. In note 24 to the financial statements, payables from exchange transactions are therefore understated by R352 870 500 (2015: R274 867 634) and receivables from exchange transactions by R144 038 951.

Unauthorised expenditure

10. The municipality did not include particulars of all unauthorised expenditure and did not adhere to the disclosure requirements in note 51 to the financial statements as required by section 125(2)(d)(i) of the MFMA. The municipality incurred expenditure in excess of the approved budget that was not disclosed as unauthorised expenditure, with the result that unauthorised expenditure was understated by R147 314 940 (2015: R81 078 668).

Irregular expenditure

11. The municipality did not include particulars of all the irregular expenditure incurred in the notes to the financial statements, as required by section 125(2)(d)(i) of the MFMA. The municipality made payments in contravention of the supply chain management regulations that were not included in irregular expenditure, with the result that irregular expenditure was understated by R44 782 960 (2015: R16 715 209). I was not able to determine the full extent of the misstatement as it was impracticable to do so. In addition, during 2012-13, irregular expenditure was written off without proper investigations having been performed. This resulted in a further understatement of the closing balance of irregular expenditure by R71 142 949 (2015: R71 142 949).

Deviations

12. The municipality did not disclose particulars of all deviations and the disclosure requirements in the financial statements as required by regulation 36(2) of the municipal supply management regulations. The municipality deviated from normal supply change management procedures, which was not disclosed, with the result that the deviation disclosure was understated by R24 281 755.

Commitments

13. The municipality did not disclose all commitments as required by GRAP 16, *Property, plant and equipment* in the financial statements. Consequently commitments are understated by R38 290 151. In the prior financial year, I was unable to obtain sufficient appropriate audit evidence for capital commitments due to an inadequate contract management system and incomplete contract register. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments to commitments stated at R40 113 980 as at 30 June 2015 as disclosed in note 44 to the financial statements were necessary.

Fruitless and wasteful expenditure

14. The municipality did not include particulars of all the fruitless and wasteful expenditure incurred in note 52 to the financial statements, as required by section 125(2)(d)(i) of the MFMA, resulting in fruitless and wasteful expenditure of R7 522 117 I was not able to determine the full extent of the misstatement as it was impracticable to do so. In addition, fruitless and wasteful expenditure was written off during 2012-13 without proper investigations having been performed. This resulted in an understatement of the closing balance of fruitless and wasteful expenditure by R17 727 744 (2015: R17 727 744).

Comparison of budget and actual amounts

15. The municipality did not disclose the final approved adjustment budget figures in the financial statements in accordance with GRAP 24, *Presentation of budget information in financial statements*. I identified various material differences between the disclosed budgeted amounts and the final adjustment budget, resulting in the figures disclosed the statement of comparison of budget and actual amounts being materially misstated.

Public-private partnership

16. The municipality did not disclose information regarding the public private partnership between the municipality and the electricity service provider as required by International Financial Reporting Interpretations Committee (IFRIC) 12, Service concession arrangements.

Distribution losses

17. The municipality did not include particulars of material losses in the notes to the financial statements as required by section 125(2)(d)(i) of the MFMA. I was not able to determine the full extent of the misstatement as it was impracticable to do so.

Cash flow statement

18. The municipality did not disclose the cash flow amounts in the financial statements in accordance with GRAP 2, *Cash flow statements*. I identified various material differences between the disclosed amounts and the actual amounts and the accounting records that could not be supported. I was unable to confirm the cash flow statement by alternative means.

Disclaimer of opinion

19. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

20. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material impairments

21. As disclosed in note 11 to the financial statements, receivables from non- exchange transactions were impaired by R15 106 739 (2015: R19 172 701) and, as disclosed in note 12 to the financial statements consumer receivables from exchange transactions were impaired by R202 197 921 (2015: 192 544 905).

Going concern

22. Note 50 to the financial statements indicates that the municipality has, on more than one occasion, not paid employees' salaries on time. The municipality has been deducting pension fund contributions and pay-as-you-earn from employees' salaries, but has been unable to pay over R32 158 728 (2015: R20 422 585) of these amounts deducted to the relevant third parties as disclosed in note 50. In addition, the municipality owed Eskom R53 266 541 (2015: R15 237 315) and Department of Water Affairs R107 921 391 (2015: R77 535 433) as at 30 June 2016, which is long overdue. These conditions, along with other matters as set forth in note 50, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

Restatement of corresponding figures

23. As disclosed in note 47 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of an error discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2016.

Unaudited disclosure notes

24. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Unaudited supplementary information

25. The appropriation statement set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited this statement and, accordingly, I do not express an opinion on it.

Report on other legal and regulatory requirements

26. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on them.

Predetermined objectives

27. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Key performance area 2: Deliver municipal services to the right quality and standard on pages xx to xx
 - Key performance area 5: Sound financial management and accounting on pages xx to xx
28. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for Managing Programme Performance Information* (FMPPI).
29. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
30. The material findings in respect of the selected key performance areas are as follows:

KPA 2: Deliver municipal services to the right quality and standard

Usefulness of reported performance information

31. The measurability of important planned indicators and its related targets could not be assessed due to a lack of technical indicator descriptions, proper systems and processes and formal standard operating procedures or documented system descriptions.
32. Section 41(c) of the Municipal Systems Act, 2000 (Act no 32 of 2000) (Municipal Systems Act) requires the integrated development plan to form the basis for the annual report, thereby requiring consistency of objectives, indicators and targets between planning and reporting documents. Important reported indicators were not consistent with those in the approved annual performance report.
33. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The relevance of important indicators could not be assessed due to a lack of corroborative supporting evidence to verify management's explanation why the indicators were considered important and relevant to the realisation of strategic goals and objectives.

Reliability of reported performance information

34. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

KPA 5: Sound financial management and accounting

Usefulness of reported performance information

35. The measurability of important planned indicators and its related targets could not be assessed due to a lack of technical indicator descriptions, proper systems and processes and formal standard operating procedures or documented system descriptions.
36. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, thereby requiring consistency of objectives, indicators and targets between planning and reporting documents. Important reported indicators were not consistent with those in the approved annual performance report.
37. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The relevance of important indicators could not be assessed due to a lack of corroborative supporting evidence to verify management's explanation why the indicators were considered important and relevant to the realisation of strategic goals and objectives.

Reliability of reported performance information

38. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was because of the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures. In addition, in the reported achievements against planned targets of importance some indicators were not reliable when compared to the evidence provided.

Additional matter

39. I draw attention to the following matter:

Achievement of planned targets

40. Refer to the annual performance report on pages x to x and x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance areas reported in paragraphs XX to XX of this report.

Compliance with legislation

41. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Financial statements and performance reports

42. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer of audit opinion.
43. The annual performance report for the year under review did not include the performance of the municipality and the external service providers, a comparison of the performance with set targets and a comparison with the previous financial year and measures taken to improve performance as required by section 46 (1)(a)(b)(c) of the Municipal Systems Act.

Budgets

44. Unforeseen and unavoidable expenditure incurred by the municipality was not approved by the mayor as required by section 29(1) of the MFMA.
45. The total unforeseen and unavoidable expenditure incurred exceeded 5% of own revenue, in contravention of Municipal Budget and Reporting Regulation 72.

Expenditure management

46. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
47. An effective system of expenditure control, including procedures for the approval and authorisation of funds, was not in place, as required by section 65(2)(a) of the MFMA.
48. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, as required by section 65(2)(b) of the MFMA.
49. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA.
50. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.
51. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

52. The Municipal Infrastructure Grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of the DoRA.

Consequence management

53. Unauthorised expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
54. Irregular expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).
55. Fruitless and wasteful expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).

Procurement and contract management

56. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
57. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer, even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
58. Invitations for competitive bidding were not always advertised for the required minimum period of days, as required by SCM regulation 22(1) & 22(2).
59. Contracts were extended without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
60. Awards were made to providers who are in the service of other state institutions in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

Strategic and annual planning process

61. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how these are conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the Municipal Systems Act and the Municipal planning and performance management regulation 7.
62. The performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan, did not clarify the roles and responsibilities of each role player, did not determine the frequency of reporting and the lines of accountability, did not relate to the employee's performance management processes and did not link to the integrated development planning processes as required by section 38(a) of the Municipal Systems Act and Municipal planning and performance management regulation 7(2)(c)(e)(f)(g).
63. The performance management system also did not provide for the monitoring, measuring and review of performance at least once per year, as required by section 41 of the Municipal Systems Act.
64. Key performance areas in respect of each of the development priorities and objectives were not set out in the integrated development plan, as required by section 41(1)(a) of the Municipal Systems Act and the Municipal planning and performance management regulation 1 and 9(1)(a).
65. The key performance area set by the municipality did not include indicators of percentage of households with access to basic level of water, sanitation, electricity and solid waste removal, and these were not set by the municipality as required by section 43(2) of the Municipal Systems Act and the Municipal planning and performance management regulation 10(a).
66. Performance targets were not set for each of the key performance areas for the financial year as required by section 41(1)(b) of the Municipal Systems Act and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
67. The amendment(s) to the integrated development plan was not adopted by the council only after all the members of council have been given reasonable notice; and the proposed amendment has been published for public comment as required by Municipal planning and performance management regulation 3(4)(5)(6).
68. The local community was not afforded the opportunity to comment on the final draft of the integrated development plan(IDP) before adoption, as required by section 42 of the Municipal Systems Act and Municipal planning and performance management regulation 9, 13(1), 13(4)(c) and 15(3).

Internal control

69. I considered internal control relevant to my audit of the financial statements, the performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion and the findings on the performance report and compliance with laws and regulations included in this report.

Leadership

70. Management did not adequately respond to the AGSA's message, as they did not effectively discharge their oversight responsibilities to ensure an improvement in the audit outcome.
71. The leadership did not always take timely and adequate action to address weaknesses in the finance and supply chain management directorate due to a lack of monitoring and supervision, which resulted in non-compliance with applicable legislation and gave rise to irregular expenditure.
72. Leadership did not continually implement preventive measures to address weaknesses in the control environment to promote ethical values and good governance that protected and enhanced the interests of the municipality. This was identified since there were no processes in place to enable effectiveness of internal controls that ensured reliability and validity of financial information. Poor performance or deviations from the expected standards of conduct were not followed up to ensure that remedial or disciplinary action was taken in a timely and consistent manner. It is concerning to note that matters regarding health hazards identified in the prior year have still not received the required attention. Overriding of internal controls resulted in a high number of instances of irregular and fruitless and wasteful expenditure where value for money was not always received, which resulted in potential cases of fraud that need to be investigated by management. Although this matter was raised in the prior year also, these matters have still not been investigated.
73. Consequence management was not effective, as the council did not investigate instances of unauthorised, irregular and fruitless and wasteful expenditure to determine whether any person was liable for the expenditure as the council neglected to appoint a committee to investigate the expenditure.

Financial and performance management

74. Proper record keeping during the current and previous year's audits, was not implemented in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting, as management did not monitor to determine whether the controls were implemented effectively. As a result, significant difficulties were experienced in respect of the availability of information.
75. Effective performance systems, processes and procedures as well as the management thereof had not been adequately developed and implemented due to a lack of capacity.
76. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing due to a lack of skilled staff.
77. Ongoing monitoring and supervision were not undertaken to enable an assessment of the effectiveness of internal control over financial and performance reporting due to the fact that the accounting officer and chief financial officer positions were filled in an acting capacity for the financial year. Therefore, internal control deficiencies were not identified, communicated and corrected in a timely manner.
78. Management also did not establish effective monitoring and evaluation components or processes within its finance and strategic planning directorates to review and monitor management's compliance with laws and regulations, and internally designed policies and procedures regularly due to capacity problems. As a result, significant non-compliance issues were noted that could have been prevented.

Governance

79. The implementation of external audit recommendations was not prioritised and monitored effectively, with the result that the prior year audit findings were not all addressed.
80. As a result of inadequate support by management to the functioning of the internal audit unit, the audit committee could not adequately promote accountability and service delivery by evaluating and monitoring responses to risks and overseeing the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Auditor-general

Bloemfontein

30 November 2016



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence